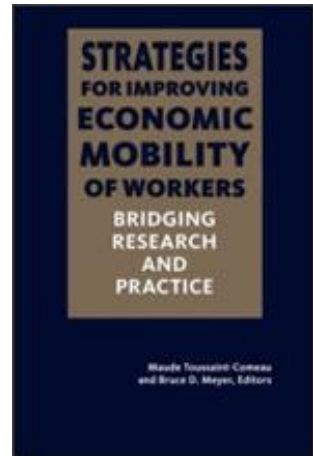

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Reflections on Economic Mobility and Policy

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5

Reflections on Economic Mobility and Policy

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This chapter comments on presentations from the “Strategies for Improving Economic Mobility of Workers” conference and discusses trends in the material circumstances of Americans. I will also briefly discuss some policies that have been used to equalize the distribution of resources.

In looking at trends over the past 30 years in the material circumstances of U.S. residents (I am defining “material circumstances” to include wages, income, and poverty, as well as food consumption, purchases of other goods, housing quality, and access to health care), there are two main patterns one should keep in mind. The two patterns are 1) increased inequality in income and consumption and 2) improvements at almost all points of the distribution of material circumstances, when properly measured. These patterns may not be apparent in all measures of material circumstances, but they are the general tendency. Often only one of these patterns is emphasized by researchers or pundits, but the two patterns really should be discussed together because each one by itself gives a distorted impression of how the economy has changed.

A third pattern I am going to mention, increased income volatility, is different. It is not clear whether volatility has increased in recent years, since there is conflicting evidence. Moreover, if income volatility is indeed increasing, what that means for the well-being of the population is not clear at all.

Regarding the first pattern, increased inequality, Autor (2009) has shown in the first chapter of this book that hourly wage growth from 1973 through 1989 was remarkably linear across the various percentiles. In other words, wages fell somewhat at the bottom, changed little

in the middle, and grew modestly at the top. From 1989 through 2005, in contrast, wage growth was polarized, with high growth at the bottom and the top and little growth between the thirtieth and the seventieth percentiles. Autor suggests that the growing use of computers and the changing demand for job tasks form a large part of the explanation for this pattern. He suggests that policies should encourage investment in human capital to take advantage of likely future growth in education-intensive “abstract” jobs.

Berube (2007) emphasizes that regional growth in productivity and employment and regional changes in poverty have been uneven. While cities continue to have higher poverty rates than suburbs, suburban growth has meant that slightly more than half of the poor now reside in suburbs. He notes that when poverty rises, it seems to rise more for children. He also notes that although poverty became less concentrated in particular neighborhoods within cities during the 1990s, this pattern appears to have reversed so far during the current decade.

Gosselin and Zimmerman (2007) examine trends in income volatility and risk. They find a substantial increase in the transitory variance of family income over time in data from the Panel Study of Income Dynamics (PSID). This pattern of increased variance seems to be much more pronounced in the PSID than in the alternative data set they examine, the Survey of Income and Program Participation (SIPP).

The PSID data indicate a large increase in the likelihood of a 50-percent drop in family income over two years. This increase comes not through a greater likelihood of a bad event occurring (such as unemployment or disability), but through a greater likelihood that a bad event will be associated with a 50-percent drop in family income.

On this issue of volatility, I do not believe that the facts are clear; nor is it clear how any trends should be interpreted. First, what are the facts? As mentioned, there is some conflicting evidence on the trends in income variability. In contrast to Gosselin and Zimmerman (2007), Dahl, DeLeire, and Schwabish (2007), in a Congressional Budget Office report, examine Social Security records and find a decline in income variability in recent years. Their evidence is at the individual level, rather than the family level, which clouds the interpretation. Another research team that uses a version of the same data, Kopczuk, Saez, and Song (2007), finds the same pattern. Thus, there is a question as to what have been the changes over time in income variability (also see the

recent working paper by Shin and Solon [2008], who find little change in volatility since 1980 until an upward trend in the last few years).

Leaving aside this puzzle, a deeper question is whether these measures of volatility are good measures of people's material circumstances. The Kopczuk, Saez, and Song (2007) paper argues that more variability is good. The authors say such variability makes possible the American dream of upward mobility. On the other hand, Gosselin and Zimmerman (2007) argue that trends in family income volatility reflect increased economic risk and are thus bad.

To better understand the two ways of looking at volatility, consider the situation in which the share of people in poverty is roughly constant over time. In fact, the official income poverty measure (pretax money income, which is similar to the Gosselin and Zimmerman [2007] income measure) was exactly the same in 1970 and 2005 (and has fallen only slightly since). If the level of poverty is roughly constant, then if more people are falling into poverty, more people must be leaving. Gosselin and Zimmerman emphasize the former, while Kopczuk, Saez, and Song (2007) emphasize the latter. The patterns are merely opposite sides of the same coin.

It should be clear from this discussion that for research and policy we probably should focus on changes in the distribution of resources over time, rather than on volatility or mobility measures. We know that if the bottom of the resource distribution shifts down but the remainder of the distribution is unchanged, society is worse off. Similarly, if the entire distribution shifts up, we know society is better off. Volatility measures are of secondary or tertiary importance because their interpretation is unclear. This discussion also suggests that we might be better off looking at the frequency with which people have extended periods of poverty.

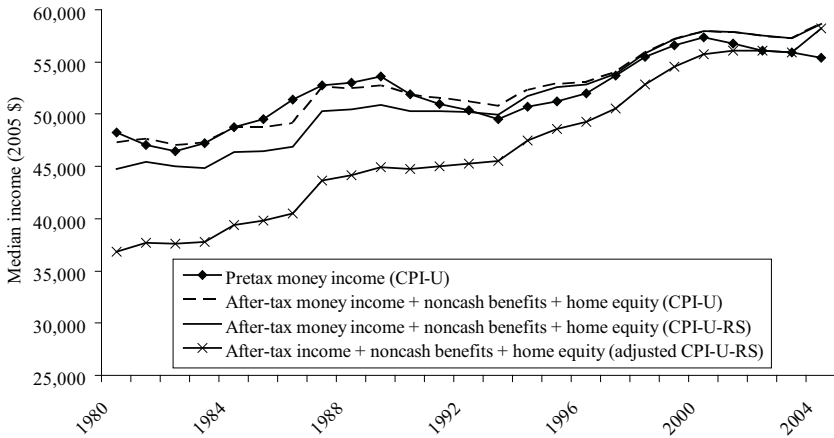
In any case, if we are examining severe drops in income, their interpretation depends on whether or not the decrease in income means families are hungry, ill-housed, or suffering from other types of material deprivation. Families have many ways to shield their standard of living as their income falls. These ways include obtaining resources from government programs, borrowing money for the short term, and drawing down savings. While it is difficult to examine some of these patterns directly, researchers and policy analysts can study the consumption patterns of families. As I will describe in greater detail below, consump-

tion measures show a decline in poverty overall, with the decline being especially large for measures of severe poverty.

Dahl (2007) shows that the incomes of households with children have grown over time. Low-income households with children (i.e. the bottom 20 percent) have had increases in income over the past 15 years. Single-mother households have seen their income rise noticeably over the past 15 years, mostly because of increases in earnings and to a lesser extent because of the Earned Income Tax Credit (EITC). The growth in earnings in percentage terms has been greatest in the bottom 20 percent of households with children (but it started at a low level). Dahl notes that she is not able to account for the effects of the Food Stamp Program and public health insurance coverage in her calculations. I should also mention that her measure excludes public and subsidized housing benefits.

I am more upbeat about the living standards of most people than even Dahl. Most researchers rely on government income statistics that overadjust for inflation. This overadjustment makes it seem that living standards have not improved. The official government adjustment for price changes does not adequately account for new goods, does not consider lower prices at discount stores such as Wal-Mart, and misses much of the quality improvements in existing goods. It also does not fully account for the fact that when the price of one good rises relative to similar goods, people move away from purchasing it, substituting cheaper alternatives in its place.

The Boskin Commission (Boskin et al. 1996), a group of eminent economists appointed by the Senate Finance Committee, concluded that the official government price measure is biased upward by 1.3 percentage points per year. Subsequent research has mostly supported this conclusion. The implication of this mismeasurement of inflation is that median family incomes have actually risen faster than reported by the Census Bureau (Meyer and Sullivan 2007). Figure 5.1 shows the evolution of median income using better measures of inflation and accounting for taxes and noncash benefits. In addition, many other factors affecting measurement suggest we are better off than official reports indicate. Measures of income-based poverty that account for taxes and transfers have fallen sharply since 1980. Measures of poverty based on what people are able to purchase in food and housing—i.e., consumption poverty measures—have fallen even faster, as can be seen

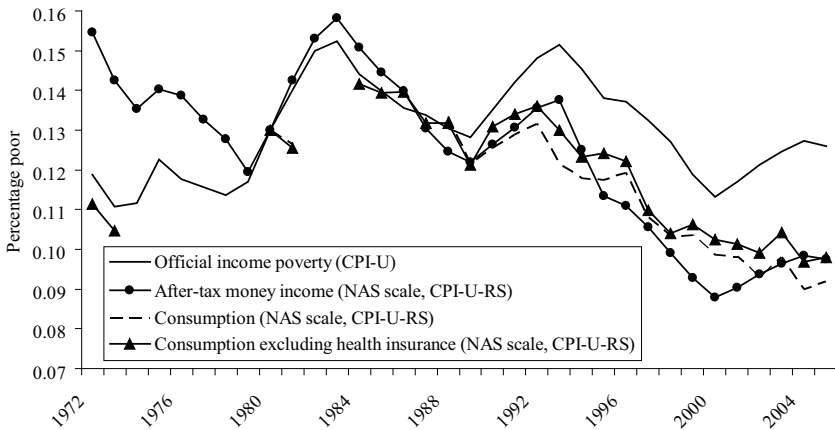
Figure 5.1 Real Median Family Income, 1980–2004

NOTE: Medians are reported for the individually weighted, scale-adjusted distribution of family income for each measure of income. We use the National Academy of Sciences (NAS)–recommended equivalence scale. After-tax income + noncash benefits + home equity includes taxes and credits, capital gains and losses, food stamps, Current Population Survey (CPS)–imputed measures of housing and school lunch subsidies, the fungible value of Medicaid and Medicare, the value of employer health benefits, and the value of the net return on home equity. See Meyer and Sullivan (2007) for details.

in Figure 5.2. The fraction of those with consumption below half of the poverty line, so-called deep poverty, has fallen faster yet (Meyer and Sullivan 2009).

All of these trends in material circumstances provide the background for policy to address the situation of workers today. Better-measured numbers indicate that we are not as badly off as official statistics and news reports suggest. One might conclude from this that there is less need for policy. On the contrary—the numbers show that some past policies have been successful and suggest that additional policies might be able to build on that success. Two types of policies that come up repeatedly are 1) education or other human capital building and 2) work subsidies, such as the EITC.

Just as Autor (2009) and Berube (2007) propose investing in human capital, Blinder (2007) contends that we need to think about how to edu-

Figure 5.2 Consumption and Income Poverty Rates, 1972–2005

NOTE: Rates anchored at 1980. All poverty rates are at the person level. Consumption data are from the Consumer Expenditure Survey (CE), and income data are from the Current Population Survey's Annual Social and Economic Supplement (CPS-ASEC), formerly known as the Annual Demographic Survey (ADS). CE survey data are not available for the years 1974–1979 and 1982–1983. Also, consumption data are not available for the years 1984–1987 for measures that include health insurance. See Meyer and Sullivan (2009) for details.

cate the next generation of workers. Both Autor and Blinder acknowledge that it is hard to predict which industries and occupations will see employment increases, which will see declines, and when these changes will occur. They make general predictions but provide few specifics. There remain tough decisions to be made about whose human capital should be enhanced and what skills these people need. We have little guidance from research to date on these questions.

Both Dahl (2007) and Berube (2007) discuss how the EITC is targeted to families with children; Holzer (2009) suggests expanding the EITC; and Hoynes (2009) addresses the impact of the EITC. Hoynes notes that the tax credit sharply increased the employment of single mothers in the 1990s, and for much of the recent period it had perhaps as big a role in employment changes as welfare reform. She, like Holzer, suggests that we should consider expanding the EITC, since there are groups that do not especially benefit from the current EITC,

such as childless men and women and some groups of low-income married couples.

In thinking about these possible expansions in the EITC, we should keep a couple of points in mind. First, by expanding the credit to reach more people, our policy could encourage work while transferring resources to low-income individuals. Second, the EITC likely was successful in increasing the employment of single mothers because 1) they had a low employment rate to start with, and 2) before the EITC, their net financial reward for work was low because working often meant losing welfare, food stamps, and other benefits. Neither of these conditions will be as true for other groups, such as childless men and women. Thus, while such a reform may have favorable distribution effects, it should not be expected to increase employment sharply.

Hoynes (2009) suggests that we should consider raising the maximum EITC amount and raising the implicit tax rate over the phaseout portion of the credit (such a change could be revenue-neutral). This suggestion is based on the repeated finding that the credit has little effect on the hours worked by those already working (Eissa and Hoynes 2006; Meyer 2007). While I believe this idea has substantial merit, I have concerns that in the long run individuals will come to understand the structure of the credit, in particular the very high penalty on additional earnings that this change would create. In general, it is good for credit recipients to understand the tax rules, but we should be aware that such an understanding in this case might very well lead to a negative response on their part in terms of the number of hours worked.

I would like to offer one addition to the list of possible EITC reforms. The current benefit structure is the same for those with three or more children as for those with two. A more generous schedule for those with three or more children would help to support families that appear to be particularly needy. As can be seen in Table 5.1, those with three or more children have less resources they are able to devote to food, housing, and other consumption than single mothers with one or two children.

Overall, the evidence suggests that while we have seen a sharp increase in inequality in recent years, those at the bottom are still much better off than they were 30 years ago. This improvement in well-being can be taken as either of two things: 1) an indication that poverty is less of a problem than advertised or 2) evidence that past policy efforts (and economic growth) have been successful and should be expanded.

Table 5.1 Percentiles of Annual Income of Single Mothers, by Number of Children, 2001–2003

Income percentile	1 child	2 children	3+ children
Fifth	\$3,567	\$3,558	\$3,675
Tenth	5,593	5,949	6,186
Twentieth	9,025	9,874	8,843
Thirtieth	12,374	12,207	11,406
Fortieth	15,366	15,151	13,464
Fiftieth	19,351	19,353	16,394
Ninetieth	41,246	47,637	36,291

SOURCE: Author's calculations using Consumer Expenditure Survey data. See Meyer (2007) for details.

We have several options for expanding earnings subsidies such as the EITC. Besides this, a common suggestion for improving the earnings of the worst-off is improved education and training. We need more evidence on what type of education would be most effective and for what type of person targeted efforts would prove most beneficial.

Note

This chapter was originally a paper prepared for the conference “Strategies for Improving Economic Mobility of Workers,” organized by the Federal Reserve Bank of Chicago and the W.E. Upjohn Institute, November 15–16, 2007.

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